Supreme Court, U.S.
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No. 04-172

IN THE

Supreme Court of the United States

U.S. BANK NATIONAL ASSOCIATION,
CHASE MANHATTAN BANK, USA,
NATIONAL ASSOCIATION, as Indenture Trustees,
and DR. BEN S. BRANCH, Chapter 7 Bankruptcy Trustee,

Petitioners,

v.

HSBC BANK USA and JPMORGAN CHASE BANK,
as Indenture Trustees,

Respondents.

ON PETITION FOR A WRIT OF CERTIORARI TO THE
UNITED STATES COURT OF APPEALS FOR THE FIRST CIRCUIT

PETITION FOR A WRIT OF CERTIORARI

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QUESTIONS PRESENTED

1. When Congress enacted Section 510(a) of the Bankruptcy Code, 11 U.S.C. § 510(a), and provided therein for enforcement of subordination agreements according to "applicable nonbankruptcy law," did it mean to preserve the pre-Code judicial practice of applying a federal common law canon of contract interpretation known as the Rule of Explicitness, or did it mean to abrogate use of this federal canon and instead require use of state law interpretive rules?

2. If the latter, did the First Circuit — in direct conflict with the Eleventh Circuit — err in refusing to accept and apply the New York Court of Appeals' determination that the Rule of Explicitness is a part of New York state law?

PARTIES TO THE PROCEEDINGS BELOW

In the court of appeals, this matter was captioned *In re Bank of New England Corp. (HSBC Bank USA and JPMorgan Chase Bank, as Indenture Trustees v. Dr. Ben S. Branch, Trustee in Bankruptcy)*. Dr. Ben S. Branch, in his capacity as bankruptcy trustee, administers the bankruptcy estate of the Bank of New England Corporation, a Chapter 7 debtor. HSBC Bank USA and JPMorgan Chase Bank (together, the "Senior Indenture Trustees") are the indenture trustees under three senior debt offerings issued by the debtor. U.S. Bank National Association and Chase Manhattan Bank, USA, National Association (successor by merger with Chemical Bank Delaware) (together, the "Junior Indenture Trustees") are the indenture trustees under three junior debt offerings issued by the debtor.

The issue before this Court involves the bankruptcy trustee's request to distribute approximately $11 million from the debtor's bankruptcy estate to the Junior Indenture Trustees. Because the Senior Indenture Trustees objected, in the proceedings below, to the bankruptcy trustee's proposed distribution on the basis that the funds were properly distributable to themselves, the Junior Indenture Trustees and the bankruptcy trustee are denominated the Petitioners in this Court, and the Senior Indenture Trustees are denominated the Respondents.

CORPORATE DISCLOSURE STATEMENT

Pursuant to S. Ct. R. 29.6, Petitioners U.S. Bank National Association and Chase Manhattan Bank, USA, National Association (successor by merger with Chemical Bank Delaware), in their respective capacities as Junior Indenture Trustees, state, by their counsel, the following: (a) U.S. Bank National Association, successor by merger with U.S. Bank Trust National Association, is wholly owned by U.S. Bancorp, a publicly-owned company; (b) Chase Manhattan Bank, USA, National Association (successor by merger with Chemical Bank Delaware) is wholly owned by JPMorgan Chase & Co., a publicly-owned company.

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PETITION FOR A WRIT OF CERTIORARI

Petitioners U.S. Bank National Association, Chase Manhattan Bank, USA, National Association (successor by merger with Chemical Bank Delaware), as Indenture Trustees, and Dr. Ben S. Branch, Chapter 7 Bankruptcy Trustee, respectfully petition for a writ of certiorari to review the judgment of the United States Court of Appeals for the First Circuit in this case.

OPINIONS BELOW

The opinion of the First Circuit (App. 1a-21a) is published at 364 F.3d 355. Its order denying rehearing *en banc* (App. 42a-43a) is unpublished. The opinions of the district court (App. 22a-33a) and bankruptcy court (App. 34a-41a) are published at, respectively, 295 B.R. 419 and 269 B.R. 82.

JURISDICTION

The court of appeals issued its opinion on April 13, 2004, and denied a timely-filed petition for rehearing *en banc* on May 5, 2004. This Court has jurisdiction pursuant to 28 U.S.C. § 1254(1).

STATUTORY PROVISION INVOLVED

11 U.S.C. § 510(a) provides:

> A subordination agreement is enforceable in a case under this title to the same extent that such agreement is enforceable under applicable nonbankruptcy law.

STATEMENT

For thirty years, courts have recognized, and investors have relied upon, a federal common law canon of contract interpretation known as the Rule of Explicitness. *See Chemical Bank v. First Trust of New York, Nat'l Ass'n (In the Matter of Southeast Banking Corp.)*, 688 N.Y.S.2d 484, 487, 710 N.E.2d 1083, 1086 (N.Y. 1999) (acknowledging the Rule and noting that parties have "undoubtedly relied on [it] — their lawyers would have been quite remiss had they not — since recent case law, as well as a leading authority and many commentators have consistently recognized the continued vitality of the Rule") (citations omitted). The Rule of Explicitness permeates "a vast sea of subordination agreements . . . involving enormous sums of outstanding public debt." *Id.* Now, however, the decision of the First Circuit threatens to send a tidal wave of uncertainty through the settled financial expectations in that vast sea.

As described more fully below, the Rule of Explicitness is a guide for the interpretation and enforcement of subordination agreements. The First Circuit determined that the federal version of the Rule was displaced by the enactment of Section 510(a) of the Bankruptcy Code in 1978, even though Section 510(a) instructs courts to enforce subordination agreements in accordance with "applicable nonbankruptcy law" — a phrase which this Court has consistently construed to include both federal law (like the Rule) and state law (here, the law of New York). By first declaring the federal Rule of Explicitness a "dead letter," App. 3a, and then refusing to accept and apply the state law version of the Rule (even though expressly recognized as part of state law by the New York Court of Appeals), the First Circuit has rendered uncertain the terms of hundreds of billions of dollars of subordinated debt issues, the substantial majority of which — as in this case — are governed by New York law.

1. Both before and after the enactment of the Bankruptcy Code in 1978, bankruptcy law has been clear that an unsecured creditor cannot recover post-petition interest (interest which accrues after the date on which the debtor filed its bankruptcy petition) from the debtor. *See* 11 U.S.C. § 502(b) (directing the bankruptcy court to determine the amount of an unsecured creditor's claim "as of the date of the filing of the petition" and disallowing any claim "for unmatured interest"); *United States v. Ron Pair Enters., Inc.*, 489 U.S. 235, 246 (1989) (acknowledging "pre-Code rule that the running of interest ceased when a bankruptcy petition was filed"); *Vanston Bondholders Protective Comm. v. Green*, 329 U.S. 156, 163 (1946) ("The general rule in [pre-Code] bankruptcy . . . has been that interest on the debtors' obligations ceases to accrue at the beginning of proceedings."). Thus, as between a debtor and its unsecured creditors, the amount of a debtor's indebtedness to such class is fixed as of the petition date.

Unsecured creditors may, however, agree *among themselves* — outside of the bankruptcy law limitations on what the debtor owes them — to reallocate the recoveries they receive from the debtor. By such agreement, a junior creditor agrees to forfeit its share of distributions from the bankruptcy estate until such time (if ever) that the senior creditor recovers an amount equal to the post-petition interest it cannot itself collect directly from the debtor. While these arrangements, which typically take the form of a subordination or intercreditor agreement, do not (indeed, by virtue of the Bankruptcy Code, *cannot*) increase the total amount *the debtor* must pay to its general unsecured creditors, they effect a reallocation of payments from one group of unsecured creditors to another.

Because the contractual reallocation of bankruptcy assets contravenes accepted bankruptcy principles regarding the suspension of post-petition interest to, and the equitable, *pro rata* allocation of bankruptcy assets among, unsecured creditors, pre-Bankruptcy Code courts called upon to enforce subordination agreements demanded that such agreements contain language sufficiently specific and express that a junior subordinated creditor would know with certainty whether it had, in fact, forfeited its right to recover its normal distributions pending payment of post-petition interest to the senior subordinated creditor. These requirements of specificity became embodied in the so-called Rule of Explicitness.

First denominated as such by the court in *In the Matter of Kingsboro Mortgage Corp.*, 379 F. Supp. 227 (S.D.N.Y. 1974),[1] the Rule of Explicitness provides that a subordination agreement will be enforceable only if it contains "precise, explicit and unambiguous"[2] language alerting junior unsecured creditors to the payment — to senior unsecured creditors, to fund their claims for post-petition interest — of monies to which the junior creditors would otherwise be

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1. The rule . . . that[,] before a right to 'post-petition' interest and a concomitant reduction in dividends to subordinated creditors may be recognized, 'the agreement should clearly show that the general rule that interest stops on the date of the filing of the petition is to be suspended, at least vis-à-vis these parties,' is no more than *a rule of 'explicitness'*. . . .

379 F. Supp. at 231 (emphasis added) (citations omitted).

2. *Id.*

entitled from a debtor's bankruptcy estate. Over the three decades of its application, the Rule has been distilled to require a specific reference to "post-petition interest" in the governing subordination agreement before junior creditors will be required to forfeit their distributions to senior creditors. *See Chemical Bank v. First Trust of New York, Nat'l Ass'n (In re Southeast Banking Corp.)*, 179 F.3d 1307, 1310 (11th Cir. 1999) ("[W]e find it beyond question that the subordination language in the indenture agreements in this case, which requires 'payment in full' *without any specific reference to post-petition interest*, is insufficiently 'precise, explicit and unambiguous' on the topic of post-petition interest to satisfy the Rule of Explicitness.") (emphasis added); *Bankers Life Co. v. Manufacturers Hanover Trust Co. (In re Kingsboro Mortgage Corp.)*, 514 F.2d 400, 401 (2d Cir. 1975) (determining that "paid in full" was "insufficiently express to relate to post-bankruptcy interest" and that senior creditors were not entitled to post-petition interest where "the contract *does not explicitly refer to post-bankruptcy interest*") (emphasis added).

2. By enacting the Bankruptcy Code in 1978, Congress incorporated numerous preexisting judicial practices and rules into the Code's statutory provisions, as this Court has consistently recognized. *See Midatlantic Nat'l Bank v. New Jersey Dep't of Environmental Protection*, 474 U.S. 494, 501 (1986) ("The normal rule of statutory construction is that if Congress intends for legislation to change the interpretation of a judicially created concept, it makes that intent specific. The Court has followed this rule with particular care in construing the scope of bankruptcy codifications.") (citations omitted); *Pennsylvania Dep't of Pub. Welfare v. Davenport*, 495 U.S. 552, 565 (1990) (Blackmun, J., dissenting) ("[T]he Court presumes that Congress intended to keep continuity

between pre-Code judicial practice and the enactment of the Bankruptcy Code in 1978.").

Among these provisions was Section 510(a), which codified the pre-Code enforcement of subordination agreements:

> A subordination agreement is enforceable in a case under this title to the same extent that such agreement is enforceable under applicable nonbankruptcy law.

11 U.S.C. § 510(a). As is evident, Section 510(a) conditions the enforcement of subordination agreements on "applicable nonbankruptcy law," a phrase which appears in several provisions of the Bankruptcy Code and which this Court has construed to encompass both state and federal law. *Patterson v. Shumate*, 504 U.S. 753, 758 (1992) ("Reading the term 'applicable nonbankruptcy law' in § 541(c)(2) to include federal as well as state law comports with other references in the Bankruptcy Code to sources of law.").

Following the enactment of Section 510(a) in 1978, courts continued to apply and enforce the principles underlying the Rule of Explicitness. *See, e.g.*, *First Fidelity Bank, Nat'l Ass'n v. Midatlantic Nat'l Bank (In re Ionosphere Clubs, Inc.)*, 134 B.R. 528, 533-34 (Bankr. S.D.N.Y. 1991) (citing *In re Kingsboro Mortgage Corp.* and other cases and concluding that "*Kingsboro* retains its vitality and remains the controlling law in the Second Circuit"); *see also In re EnviroDyne Indus., Inc.*, No. 93 B 310, 1993 WL 566565, at *36 (Bankr. N.D. Ill. Dec. 20, 1993) (citing *In re Kingsboro Mortgage Corp.* and *In re Ionosphere Clubs, Inc.*, and confirming plan of reorganization providing for distribution

of post-petition interest payments to senior holders where governing indenture "explicitly provides for payment of post-petition interest to senior indebtedness").

3. In 1998, in *Chemical Bank v. First Trust of New York, Nat'l Ass'n (In re Southeast Banking Corp.)*, 156 F.3d 1114 (11th Cir. 1998), the Eleventh Circuit was asked to determine whether subordination language requiring "payment in full," without reference to post-petition interest, satisfied the Rule of Explicitness. Although both the bankruptcy court and the district court had concluded — in accord with the cases noted above — that the enactment of the Bankruptcy Code in 1978 did not affect the Rule, a divided panel of the Eleventh Circuit determined that § 510(a) abrogated the Rule as a federal interpretive canon. The court first observed that Section 510(a) conditioned enforceability on "applicable nonbankruptcy law." It found no independent federal statutory law to inform its interpretation of the subordination agreements at issue, and it noted that the parties before it had not argued that the Rule originated in federal common law — a suggestion which the court said it would reject in any event, based on its belief that the enforcement of private party contracts in this context did not sufficiently implicate a "distinctive federal interest." *In re Southeast Banking Corp.*, 156 F.3d at 1121 and n.8. This left only the bankruptcy court's equitable powers as the source of the federal Rule, and the Eleventh Circuit read the text of § 510(a) — which refers to nonbankruptcy *law* — as evidencing a Congressional intent to break with prior practice. *Id.* at 1123 ("When compared with [other provisions expressly invoking historic equity powers], section 510(a)'s command to enforce subordination agreements according to the applicable nonbankruptcy *law*

can only be read as a clear and contemplated break with prior practice.") (emphasis in original) (footnote omitted).[3]

The Eleventh Circuit recognized, however, that a rule for interpreting subordination agreements could, consistent with § 510(a), be located in *state* law, and that the subordination agreements before it provided for the application of New York law. *Id.* at 1121. Cognizant of the importance of the inquiry, *id.* at 1125 ("[g]iven New York's role as the nation's financial capital and our intuition that a sizeable proportion of outstanding indenture agreements include clauses that invoke New York law, as well as the importance of standardization in indenture agreements generally"), and expressing its reluctance "to predict its resolution under New York law," *id.*, the Eleventh Circuit certified the following question to the New York Court of Appeals:

> What, if any, language does New York law require in a subordination agreement to alert a junior creditor to its assumption of the risk and burden of the senior creditor's post-petition interest?

Id.

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3. In dissent, Judge Fay noted this Court's requirement that there be an express statement or clear indication that Congress intended a bankruptcy law to revoke a judicially established principle (citing *Cohen v. de la Cruz*, 523 U.S. 213, 221 (1998), as well as other decisions), and found no such clear expression in § 510(a). *In re Southeast Banking Corp.*, 156 F.3d at 1126. He also noted the Rule of Explicitness was never mentioned in the legislative history, *id.*, worked in harmony with other Code provisions, had been upheld by several courts, and "is well known and accepted by those in the financial world," *id.* at 1127.

In response to this question, the New York Court of Appeals first observed that, in its view, the enactment of Section 510(a) had not displaced the Rule of Explicitness: "The 1978 revisions to the Bankruptcy Code did not change the general rule that creditors are not entitled to post-petition interest. Thus, considerations underlying the Rule of Explicitness survive." *In the Matter of Southeast Banking Corp.*, 710 N.E.2d at 1087. The New York Court of Appeals then looked to its own previous decision in *Pavone Textile Corp. v. Bloom*, 302 N.Y. 206, 97 N.E.2d 755 (1951), which this Court affirmed as *United States v. Bloom*, 342 U.S. 912 (1952) (per curiam). *Pavone* involved a general rule prohibiting creditors from recovering post-assignment interest in the context of a general assignment for the benefit of creditors under state law. In response to claims by the United States and the State of New York for post-assignment interest, the New York Court of Appeals held that "the general rule as to post-assignment interest prevails in the absence of any statute *expressly* providing for such interest," and denied the interest claims. *In the Matter of Southeast Banking Corp.*, 710 N.E.2d at 1087 (emphasis in that text) (quoting *Pavone Textile Corp.*, 97 N.E.2d at 757). Accordingly, the New York Court of Appeals reasoned, "[t]he parallel construction and application are reasonable to carry over to the instant certified question concerning New York contract law insofar as it controls or impacts upon the underlying dispute in the Federal courts." *Id.*

The New York Court of Appeals answered the certified question as follows:

> In accordance with the Rule of Explicitness, New York law would require specific language in a subordination agreement to alert a junior creditor to its assumption of the risk and burden of allowing

> the payment of a senior creditor's post-petition interest demand.

Id. at 1088. Based on this response, the Eleventh Circuit concluded that "New York law applies the Rule of Explicitness to subordination agreements," *In re Southeast Banking Corp.*, 179 F.3d at 1310, and held that the agreements before it did not satisfy the Rule, *id.*[4]

4. The instant controversy originates in a proposed payment to the Junior Indenture Trustees, as unsecured creditors of the bankruptcy estate of the Bank of New England Corporation (the "Debtor"), and (together with the Respondents) as parties to six separate debt issues offered by the Debtor in the years predating its bankruptcy filing.[5]

In May 2001, Dr. Ben S. Branch, the bankruptcy trustee for the Debtor's estate, sought authorization from the Bankruptcy Court[6] to distribute approximately $11 million to the Junior Indenture Trustees. At the time of this request, the Junior Indenture Trustees had not received any principal or interest payments from the bankruptcy estate, but the Respondents had already recovered all principal and pre-bankruptcy interest to

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4. Judge Fay concurred in the result, reiterating his view that the federal Rule of Explicitness had not been "abolished" as previously announced by the majority. 179 F.3d at 1311 (Fay, J., concurring). He also urged *en banc* consideration of that aspect of the majority's holding, but recognized that, since the appellees had prevailed, they would have "difficulty" in petitioning for such consideration. *Id.* at 1311 n.1.

5. The details of the debt issues involved are set forth in the opinions below. *See* App. 3a-4a and 35a-36a.

6. The Bankruptcy Court had jurisdiction over the bankruptcy trustee's distribution motion under 28 U.S.C. § 157.

which they were contractually entitled under the senior subordinated indentures to which they were parties. Nevertheless, Respondents objected to the bankruptcy trustee's proposed distribution, contending that certain subordination language (the "Subordination Provisions")[7] contained in the junior subordinated indentures entitled Respondents to recovery of post-petition interest before any payments could be made to the Junior Indenture Trustees.

The Junior Indenture Trustees argued that the Subordination Provisions, which contained no express reference to "post-petition interest," were insufficiently specific to satisfy the Rule of Explicitness. Applying the Rule, the United States Bankruptcy Court for the District of Massachusetts agreed that the Subordination Provisions were inadequate to overcome the Bankruptcy Code prohibition on the recovery of post-petition interest, and authorized the distribution to the Junior Indenture Trustees by the bankruptcy trustee. App. 40a-41a. The United States District Court for the District of Massachusetts affirmed, determining that the absence of a specific reference to post-petition interest was fatal to Respondents' recovery: "[F]or a claim to post-petition interest to survive the Rule of Explicitness, a subordination agreement must *specifically* reference the entitlement of the Senior Debt holders to such interest." App. 32a (emphasis added).

On appeal, although neither party before it, and neither court below, had questioned the vitality of the Rule, the First Circuit determined on its own that it had to "retreat to first

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7. The Subordination Provisions are set forth in the opinions below. *See* App. 5a; 23a-24a and 36a-37a.

principles." App. 7a. It then decreed the Rule of Explicitness "a dead letter," App. 3a, as a matter of federal law. While it recognized that "the phrase 'applicable nonbankruptcy law' *can* refer to either federal or state law," App. 10a (emphasis added), it "conclude[d] that the applicable nonbankruptcy law referred to in section 510(a) is state law (and, particularly, state contract law)." App. 11a. Then, despite its express recognition that the state's highest court had confirmed that the Rule *was* part of state law in *In the Matter of Southeast Banking Corp.*, *supra*, the First Circuit nevertheless determined that it was not required to follow the New York Court of Appeals because it had "announced a bankruptcy-only principle." App. 15a.[8] The First Circuit then proceeded to conduct its own survey of New York law and determined that it provided "compelling proof that the Rule of Explicitness is not part of New York's general contract law." App. 14a. Without any reference to the New York Court of Appeals' explicit reliance in *In the Matter of Southeast Banking Corp.* on its previous *Pavone* decision,[9] the First Circuit stated that "[n]othing in that decision [*In the Matter of Southeast Banking Corp.*] persuades us that the Rule of Explicitness is otherwise a part of the armamentarium of interpretive principles generally available to the courts under New York law." App. 15a. Accordingly, although it agreed with the lower courts that the indenture language before it

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8. "While a federal court must defer when the highest court of a state interprets the state's general contract law, no such deference is due to a state court's importation of a bankruptcy-specific rule into its own jurisprudence." App. 15a (citation and footnote omitted).

9. The New York Court of Appeals identified *Pavone* as the "precedential building block for our recognition of the applicability of the Rule of Explicitness to the instant controversy." *In the Matter of Southeast Banking Corp.*, 710 N.E.2d at 1087.

did not unambiguously provide for the recovery of post-petition interest by the senior creditors, it held that, under its view of New York law, this fact was not decisive — as it would be if the Rule of Explicitness applied — but instead remanded the matter for trial to ascertain the parties' intent:

> New York law requires that this amphiboly be resolved through a contextual examination of the parties' intent. . . . [W]e are persuaded that resolution of the intent question cannot be accomplished by the simple expedient of examining the relevant paperwork, but, rather, requires differential factfinding. . . . [W]e remand for factfinding on the parties' intent vis-à-vis post-petition interest.

App. 19a-21a.

The First Circuit recognized that its refusal to follow the New York Court of Appeals — and to apply the Rule of Explicitness to the indentures before it — placed it in direct conflict with the Eleventh Circuit: "We acknowledge that this conclusion compels us to part ways with the Eleventh Circuit. We are always reluctant to foment a circuit split, but we have no principled alternative here." App. 16a.

5. The First Circuit denied rehearing and rehearing *en banc*, and this petition for a writ of certiorari now follows.

REASONS FOR GRANTING THE PETITION

The First Circuit's refusal to recognize and apply the Rule of Explicitness has unraveled three decades of bankruptcy jurisprudence, directly contravened a decision of its sister circuit, and usurped the authority of the New York Court of Appeals to act as the final arbiter of its own state law. Moreover, it has done all of this unnecessarily: the First Circuit's decision to read the Rule out of the Bankruptcy Code is at odds with this Court's consistent view, when called upon to construe provisions of the Code, that Congress meant to preserve pre-Code judicial practice absent express evidence of contrary Congressional intent.

Only this Court can resolve this morass, which has now become very important. When the Eleventh Circuit panel majority in *In re Southeastern Banking Corp.* declared § 510(a) to have abrogated the federal version of the Rule of Explicitness, the practical effect of its ruling was mitigated by its adherence to the New York Court of Appeals' declaration that the Rule was part of New York state law. Now, however, the First Circuit has concluded that the Rule is *not* part of New York state law, at least in a way that any federal court must — or even may — follow. The result is an intractable conflict that has thrown into doubt hundreds of billions of dollars worth of bond offerings, the interpretation and enforcement of which are governed by New York law, but which will now be differently enforced in federal courts in Boston than in those in Atlanta, with those in the remainder of the country — including New York — now completely uncertain whether they should follow the highest court of that state or the neighboring federal circuit regarding this point of law.

For these important reasons, set forth in more detail below, this Court should grant review.

1. The First Circuit's conclusion that the enactment of Section 510(a) of the Bankruptcy Code in 1978 "extinguished the Rule of Explicitness in its classic form," App. 3a, was its primary error, and it occurred because the court of appeals did not heed this Court's well-established interpretive rule that pre-Code judicial practice is to be regarded as preserved, absent specific contrary congressional intent.[10] This Court has routinely held that provisions of the Bankruptcy Code do not displace preexisting judicial practice unless Congress has made such an intent manifest. *See, e.g., Midatlantic Nat'l Bank v. New Jersey Dep't of Environmental Protection*, 474 U.S. at 501.

The preservation of pre-Code practice is particularly compelling where, as here, there is no mention in the congressional record of an intent to displace the practice. *See United Sav. Ass'n of Texas v. Timbers of Inwood Forest Assocs., Ltd.*, 484 U.S. 365, 380 (1988) (noting that "[s]uch a major change in the existing rules would not likely have been made without specific provision in the text of the statute . . . [or] without even any mention in the legislative history"); *Kelly v. Robinson*, 479 U.S. 36, 47 (1986) (citing *Midatlantic* decision and noting Court's refusal "to hold that the new Bankruptcy Code *silently* abrogated another exception created by courts construing the old Act") (emphasis added); *see also United States v. Ron Pair Enters., Inc.*, 489 U.S. 235, 252 (1989) (O'Connor, J., dissenting) ("The rule of

10. As noted, neither the lower courts nor any of the parties to this proceeding ever questioned the continuing viability (and applicability) of the Rule of Explicitness.

Midatlantic is that bankruptcy statutes will not be deemed to have changed pre-Code law unless there is some indication that Congress thought that it was effecting such a change.").

Read in the light of this Court's longstanding interpretive rule, § 510(a) is thus properly seen as sanctioning the pre-Code practice, rather than abrogating it. Prior to the enactment of the Bankruptcy Code in 1978, bankruptcy courts were not affirmatively authorized, by statute, to enforce subordination agreements; they did so exclusively in reliance on their inherent equitable authority. *See In re Southeast Banking Corp.*, 156 F.3d at 1118 ("Before Congress enacted the 1978 Bankruptcy Code, which includes a statutory provision regarding the enforcement of subordination agreements, the courts enforced those agreements pursuant to their equitable powers."). As part of the exercise of this equitable authority, and to aid in the interpretation and enforcement of subordination agreements, bankruptcy courts developed the Rule of Explicitness (necessarily a "nonbankruptcy" rule, since it does not affect the bankruptcy estate). *See In the Matter of Southeast Banking Corp.*, 710 N.E.2d at 1087 ("The Rule of Explicitness evolved as an equitable principle of contract construction in Federal common law. . . ."). The Rule of Explicitness was adopted and confirmed by the Tenth, Second, and Third Circuits. *See Continental Illinois Nat'l Bank and Trust Co. of Chicago v. First Nat'l City Bank of New York (In the Matter of King Resources Co.)*, 528 F.2d 789, 791 (10th Cir. 1976) (refusing to award post-petition interest to senior lenders where the subordination provisions "make no specific reference to the question of post-petition interest"); *In re Kingsboro Mortgage Corp.*, 514 F.2d at 401 (concluding that post-petition interest

is "not recoverable by senior creditors out of dividends due from the estate to junior creditors, at least absent a structure of priorities among creditors by express provision in the subordination contract" and further noting that the contract at issue "does not explicitly refer to post-bankruptcy interest"); *In the Matter of Time Sales Fin. Corp.*, 491 F.2d 841, 844 (3d Cir. 1974) (to be enforceable, an agreement regarding post-petition interest "should clearly show that the general rule that interest stops on the date of the filing of the petition is to be suspended, at least vis-à-vis these parties").

By enacting § 510(a), which provides that "a subordination agreement is enforceable in a case under this title," Congress made it clear that it sanctioned the bankruptcy courts' exercise of jurisdiction over the enforcement of such agreements. In addition, Congress approved the application of "nonbankruptcy" rules by providing that such agreements were to be enforced "to the same extent that such agreement is enforceable under *applicable nonbankruptcy law*." 11 U.S.C. § 510(a) (emphasis added). Although legislative history directly bearing on this choice of terms ("applicable nonbankruptcy law") is absent,[11] under this Court's "normal rule" of interpretation noted above, that fact cuts in *favor* of the continued validity of the Rule of Explicitness, not against it. Moreover, Congress is presumed to have been aware of preexisting judicial practice when enacting the Bankruptcy Code — a presumption which carries particular weight in light of the rule against post-petition interest, on which the

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11. There is no specific indication in the legislative history, for example, that Congress was using "law" in § 510(a) in some narrow, technical sense to distinguish it from "equity," as the Eleventh Circuit panel majority erroneously surmised. *Cf.* 156 F.3d at 1123.

corollary Rule of Explicitness itself was premised. *See United States v. Ron Pair Enters., Inc.*, 489 U.S. at 246 (rejecting pre-Code practice before it as "not the type of 'rule' that we assume Congress was aware of when enacting the Code" but noting, instead, and by way of example of a rule Congress *was* aware of, the "pre-Code rule that the running of interest ceased when a bankruptcy petition was filed").

Contrary to the First Circuit's conclusion, therefore, the Rule of Explicitness was not displaced by the enactment of Section 510(a) but, rather, fits comfortably within Section 510(a)'s invocation of "applicable nonbankruptcy law," as leading authorities have recognized. *See* 4 Collier on Bankruptcy ¶ 510.03[3] (Alan N. Resnick & Henry J. Sommer eds., 15th ed. rev. 2004) (describing Rule of Explicitness as "a federal common law equitable doctrine," noting that Section 510(a)'s statutory language "comports with prior law," and concluding that the statutory "reference to enforceability to the same extent as under applicable nonbankruptcy law imports *all* nonbankruptcy law defenses to the agreement") (emphasis added); Marcia B. Pine *et al.*, *The Treatment of Claims in Bankruptcy: An Outline in Retrospect*, 709 PLI/Comm 213, 305 (1995) ("Section 510(a) codifies a line of court decisions, rendered prior to the Code, that enforced the nonbankruptcy law and the intent behind contractual agreements between creditors notwithstanding otherwise overriding federal bankruptcy law."). Numerous bankruptcy courts have also recognized Section 510(a)'s codification of pre-Code case law. *See In the Matter of Holly's, Inc.*, 140 B.R. 643, 669 (Bankr. W.D. Mich. 1992) ("Section 510(a) codifies pre-Code case law in which the courts enforced [subordination] agreements."); *Mihalko v. Continental Bank and Trust Co. (In re Mihalko)*, 87 B.R. 357, 364 (Bankr. E.D. Pa. 1988) ("[510(a)] codifies results

reached in decisions construing the former Bankruptcy Act of 1898."); *Beatrice Foods Co. v. Hart Ski Mfg. Co., Inc. (In re Hart Ski Mfg. Co., Inc.)*, 5 B.R. 734, 735 (Bankr. D. Minn. 1980) (stating that Section 510(a) "codifies what was existing case law under the prior Bankruptcy Act").

2. The First Circuit's decision expressly contradicts the Eleventh Circuit's application of New York's state law version of the Rule of Explicitness in *In re Southeast Banking Corp.*, 179 F.3d 1307 (11th Cir. 1999). With identical subordination language,[12] the same governing state law, and the same definitive exposition of that state's law by the highest court of the state, the First Circuit nevertheless "part[ed] ways with the Eleventh Circuit," App. 16a, and refused to apply the Rule of Explicitness here. Moreover, in addition to conflicting directly with the Eleventh Circuit, the First Circuit's decision also contravenes pre-Bankruptcy Code case law developed by the Tenth, Second, and Third Circuits and still relied upon as good law. Not only have the *King Resources*, *Kingsboro* and *Time Sales* cases not been overruled since the enactment of Section 510(a), they continue to be cited as authority for the existence and application of the Rule of Explicitness. *See, e.g., In re Ionosphere Clubs, Inc.*, 134 B.R. at 533-34 (Bankr. S.D.N.Y. 1991) (acknowledging that "*Kingsboro* retains its vitality and *remains* the controlling law in the Second Circuit") (emphasis added); *see also In re Southeastern Banking Corp.*, 156 F.3d at 1127 (Fay, J., dissenting) (recognizing that the Rule of Explicitness was "upheld as good law by three different appellate courts").

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12. *See In re Southeast Banking Corp.*, 156 F.3d at 1117 n.5.

3. The First Circuit's refusal to acknowledge the Rule of Explicitness as part of New York state contract law, despite the express declaration by the New York Court of Appeals that the Rule *is* part of its state's law, impermissibly overrides the New York Court of Appeals' authority to define the parameters of its own state law. *Wainwright v. Goode*, 464 U.S. 78, 84 (1983) ("[T]he views of the State's highest court with respect to state law are binding on the federal courts"); *Hortonville Joint Sch. Dist. No. 1 v. Hortonville Educ. Ass'n*, 426 U.S. 482, 488 (1976) ("We are, of course, bound to accept the interpretation of [the state's] law by the highest court of the State."); *West v. American Tel. & Tel. Co.*, 311 U.S. 225, 236 (1940) ("[T]he highest court of the state is the final arbiter of what is state law [and] [w]hen it has spoken, its pronouncement is to be accepted by federal courts as defining state law. . . .").

The First Circuit's fundamental error in refusing to apply New York state law as articulated by New York's highest court is highlighted by reference to Justice Frankfurter's concurring opinion in *Vanston Bondholders Protective Comm. v. Green*, 329 U.S. 156 (1946). In *Vanston*, Justice Frankfurter observed the "classic admonition to begin at the beginning," *id.* at 169, when confronted (in the context of a bankruptcy proceeding) with indenture language purportedly entitling certain creditors to collect "interest on unpaid interest" from the debtor's estate, *id.* at 159. He thus took issue with the majority's willingness to address what he regarded as the second step (whether a federal bankruptcy court should honor an interest-on-interest obligation) without determining whether "it is an obligation created by applicable State law" in the first instance. *Id.* at 170. He started with independent, preexisting state law principles:

> The existence of a debt between the parties to an alleged creditor-debtor relation is independent of

> bankruptcy and precedes it. Parties are in a bankruptcy court with their rights and duties already established, except insofar as they subsequently arise during the course of bankruptcy administration or as part of its conduct. Obligations to be satisfied out of the bankrupt's estate thus arise, if at all, out of tort or contract or other relationship created under applicable law. And the law that fixes legal consequences to transactions is the law of the several States.

Id. at 169.

Accordingly, Justice Frankfurter concluded that the parties were entitled to assert a claim for interest on unpaid interest (and thus seek recovery of the same from the bankruptcy court) only if New York law conferred that right, as determined by the New York Court of Appeals: "In the circumstances, if the words of the indenture created an obligation, they did so only if the law of New York says they did. . . . *And the ultimate voice of New York law, [is] the New York Court of Appeals. . . .*" *Id.* at 171 (citations omitted) (emphasis added).

The First Circuit justified its refusal to follow expressly declared state law by opining that the Eleventh Circuit had certified an impermissible question to the New York Court of Appeals. App. 15a ("[T]he question that it put to the New York court was beyond that court's competence to answer"). This proffered excuse, however, reveals a fundamental misconception on the part of the First Circuit. A subordination agreement is a contract, governed by state law and, as such, subject to enforcement in a state court just as any other contract. Since a subordination agreement does not alter the

obligations of a debtor, it need not be enforced exclusively in *bankruptcy*, by a *bankruptcy* court, applying *bankruptcy* law. Accordingly, if no federal interpretive rule specially applies, a federal court called upon to enforce a subordination agreement must look to state law and, more particularly, to state law rules of contract interpretation. Since the Rule of Explicitness is a canon of contract interpretation designed to assist courts in the enforcement of subordination agreements, to the extent that New York state law recognizes the Rule — as it does, according to its own highest court — the First Circuit erred fundamentally in refusing to follow the Rule and apply it to the facts of this case.

4. Only this Court can correct the important conflict which the First Circuit has fostered, which conflict involves a topic of enormous practical significance in the financial world, as noted by the New York Court of Appeals. *See In the Matter of Southeast Banking Corp.*, 710 N.E.2d at 1086 (acknowledging "the practical effect that our answer to the certified question will have on a vast sea of subordination agreements not before us now in live cases or controversies, nor even within the framework of this . . . litigation, involving enormous sums of outstanding public debt"). In excess of $400 billion in subordinated bonds have been issued over the past decade,[13] a significant portion of which, as "intuited" by the Eleventh Circuit, "include clauses that invoke New York law." *In re Southeast Banking Corp.*, 156 F.3d at 1125; *see, e.g.*, Daniel J. Weiser & Allan Mouw, *The Basics of Debt Financing: Indenture Basics, Issues to Consider in Drafting Covenants and How to Conduct an Exxon Capital Exchange*

13. Thomson Financial, Subordinated Debt Issues 7/1/1994 - 7/26/2004, *from Database Search* "All North American Debt, exc. Mortgage" (D, PD, R144D*) available at Thomson Financial, (973) 622-5200* (July 27, 2004).

Offer, 1307 PLI/Corp 197, 230 (2002) (noting that "[a]lmost all public indentures and indentures effected privately with registration rights are governed by New York law"). If the First Circuit's decision is allowed to stand, federal courts in Boston and other financial centers within the First Circuit will be forced to follow the First Circuit's view of New York law, while federal courts in Atlanta and other financial centers in the Eleventh Circuit will be compelled to follow the New York Court of Appeals' view, with courts in other centers left to wonder which view to follow (and what to make of a denial of review of this case by this Court). *Cf. Vanston Bondholders Protective Comm.*, 329 U.S. at 172 (Frankfurter, J., concurring) (noting that "the bankruptcy clause of the Constitution [and] [t]he Constitutional requirement of [geographic] uniformity . . . is wholly satisfied when existing obligations of a debtor are treated alike by the bankruptcy administration throughout the country regardless of the State in which the bankruptcy court sits").

Moreover, as the New York Court of Appeals recognized, such uncertainty and conflict are of critical concern "especially with regard to commercial matters where reliance, definiteness and predictability are such important goals of the law itself, designed so that parties may intelligently negotiate and order their rights and duties." *In the Matter of Southeast Banking Corp.*, 710 N.E.2d at 1086. Circuits throughout the country have recognized that the effective functioning of the capital markets depends on the uniform interpretation of indentures:

> Whereas participants in the capital market can adjust their affairs according to a uniform interpretation, whether it be correct or not as an initial proposition, the creation of enduring

> uncertainties as to the meaning of boilerplate provisions would decrease the value of all debenture issues and greatly impair the efficient working of capital markets.

Sharon Steel Corp. v. Chase Manhattan Bank, N.A., 691 F.2d 1039, 1048 (2d Cir. 1982); *see also Broad v. Rockwell Int'l Corp.*, 624 F.2d 929, 943 (5th Cir. 1981) (en banc) ("A large degree of uniformity in the language of debenture indentures is essential to the functioning of the financial markets. . . ."); *In re Southeast Banking Corp.*, 156 F.3d at 1125 (11th Circuit quoting *Sharon Steel Corp.* and *Broad*, as above).[14]

All of these reasons, legal as well as pragmatic, call for this Court's review. They also call for that review to be granted now, to minimize the uncertainty and concomitant harm the First Circuit's decision is causing.

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14. It is thus no answer simply to say that the First Circuit's view will not necessarily upset the intent of the parties to such contracts. The Rule of Explicitness was developed to resolve interpretation questions as a matter of law, without the need for "differential factfinding," and it was on just such a prompt and predictable resolution that the parties — and the national financial markets — relied when valuing such instruments. Moreover, in the absence of the Rule, courts will be required (as the First Circuit itself instructed the Bankruptcy Court, on remand) to act as "triers of fact" to determine the parties' intent — a challenging exercise in any event, often compounded in the context of bond offerings, which may date back decades.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted,

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